No. 9837

In the United States Circuit Court of Appeals for the Ninth Circuit

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, TRUSTEE OF THE JOHN AND PAULINE TONNINGSEN TRUST, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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In the United States Circuit Court of Appeals for the Ninth Circuit

No. 9837

Bank of America National Trust and Savings Association, Trustee of the John and Pauline Tonningsen Trust, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion in this case is the opinion of the United States Board of Tax Appeals (R. 25–43) reported in 43 B. T. A. 37.

JURISDICTION

This case involves income taxes for the years 1935 and 1936. The decision of the Board of Tax Appeals was entered on January 31, 1941. (R. 44.) Petition for review was filed on April 26, 1941. (R. 15–18.)

The jurisdiction of this Court rests upon Sections 1141–1142 of the Internal Revenue Code.

QUESTIONS PRESENTED

1. (a) Whether the taxpayer may take as a deduction the amount of capital gains realized in 1935 as income permanently set aside for charitable purposes within the meaning of Section 162 (a) of the Revenue Act of 1934.

(b) Whether the taxpayer may take the amount of these capital gains as a deducation under Section 167 or Section 162 (c) of the Revenue Act of 1934.

2. (a) Whether certain payments made by the taxpayer to charities in 1936 were made from income of the trust, and if made from income, whether they were so made pursuant to the terms of the trust.

(b) Whether the taxpayer may take a deduction of the amount of an attorney's fee as income paid to charity within the meaning of Section 162 (a) of the Revenue Act of 1936.

STATUTES INVOLVED

The statutes involved are set out in the Appendix, *infra,* pp. 33–35.

STATEMENT

I

The facts are taken from the findings of fact by the Board of Tax Appeals and the agreed statement of the proceedings on review. They are as follows:

The taxpayer is the trustee of the John and Pauline Tonningsen Trust created August 7, 1930. (R. 27.)

The trust names John Tonningsen as the first trustor and Pauline E. Tonningsen, his wife, as the second trustor. (R. 27.) Under the terms of the trust the net income was payable to the first trustor during his lifetime. (R. 27.) At his death the trust was to become irrevocable and the net income was to be paid to the second trustor. (R. 28.) The trust instrument provided (R. 28) that if the second trustor were—

> in need of a greater amount than said net income for her care, maintenance and support, or by reason of illness or other emergency, the Trustee may, in its absolute discretion, pay to her, out of the principal of the trust fund and estate, such additional amounts as it may deem necessary and appropriate for the purposes aforesaid, and no one, howsoever interested in the Trust, shall be competent to object thereto.

On the death of the survivor of John and Pauline Tonningsen the trustee was directed to pay (R. 28–29):

> (a) Out of the income of the trust fund and estate, if that be sufficient, or out of the principal thereof, if necessary, * * * the costs and expenses of the surviving Trustor's last illness and of his or her funeral and burial, unless other provision shall have been made therefor, and the inheritance tax upon all distributive shares of or interests in the trust fund and estate, if any be due, and any Federal Estate Tax due upon the whole thereof, and the costs and expenses of the Trust, * * *.

(b) Specific gifts to individuals amounting to $104-000 which were made a charge upon both the undistributed income and the principal of the trust fund;

(c) annuities aggregating $600 per month (R. 29–30); (d) all of the net income not required for any of the foregoing purposes was to be paid to six organizations qualifying as charitable organizations under the applicable provisions of the revenue act (R. 30).

At the time of John Tonningsen's death on November 28, 1933, the taxpayer valued the assets of the trust at $702,222.51. (R. 30.) At the time of her husband's death Pauline Tonningsen was 81 years old. She was paralyzed and confined to her bed and wheel chair. This condition continued until the time of her own death on January 25, 1936. (R. 30–31.) During this period she lived in a hotel with her niece, Louise Weyer. (R. 30.) The hotel books showed expenses incurred by her for November and December of 1933 of $1,338.98; for 1934, $8,210.22; for 1935, $8,744.05; for January, 1936, $723.91. (R. 31.) During the years 1934, 1935 and 1936, her bills for physicians' services totaled $635, $796 and $122, respectively. (R. 31.)

After the death of John Tonningsen all of the income of the trust was paid to Pauline Tonningsen. (R. 31.) Beginning with February, 1934, the trustee paid Pauline Tonningsen $5,000 per month without regard to the income received by the trust. The charities which were the remaindermen of the trust had given their consent to this arrangement when the trustee had objected to making these payments unless it was held harmless by the remaindermen. The charities consented to the same arrangement in December of 1934, and again on April 3, 1935, the latter consent being for a period of one

year from March 1, 1935, or less in the event of Pauline Tonningsen's prior death. (R. 31.) The payment of this monthly sum to Pauline Tonningsen required the invasion of the corpus in 1934 to the extent of $16,-614.53, and in 1935, to the extent of $9,545.80. (R. 31.)

All payments made to Pauline E. Tonningsen were deposited in her commercial account at the Bank of America. The balance in this account was $36,615.78 on January 2, 1935, and $36,088 on December 31, 1935. Over objection that the evidence was immaterial and irrelevant, the taxpayer was permitted to show that Pauline E. Tonningsen opened a savings account with the same institution on January 5, 1934, with a deposit of $228.15; that by virtue of deposits aggregating $19,047.26 and interest credits of $334.32, the balance in the account on December 31, 1934, was $19,609.73; that during the year 1935, there was deposited in this account the sum of $5,390.27 in amounts and on dates which corresponded with withdrawals from the aforementioned commercial account; that no withdrawals were made from this savings account during the life of Pauline E. Tonningsen, and that the balance therein, on December 31, 1935, including interest credits of $523.97 in 1935, which was unchanged at the time of the death of Pauline E. Tonningsen, was $25,523.97. (R. 7–8.)

At the time of her death Pauline Tonningsen had an individual estate subsequently appraised at $87,046.67 and bank accounts in joint tenancy with Louise Weyer in the sum of $103,067.06. (R. 31–32.)

The trust estate was composed of real and personal property and yielded net income as follows (R. 32):

1931	$70,970.00
1932	73,984.18
1933	47,693.67
1934	45,571.58
1935	[1] 45,938.85

[1] According to the agreed statement of proceedings on review this income was for eleven months of the year 1935. (R. 5.)

During the year 1935, the taxpayer realized in addition to other income the sum of $32,785.40 as taxable income from capital gains. (R. 32.) The taxpayer claimed a deduction for the amount of these capital gains under the terms of Section 162 (a) of the Revenue Act of 1934. The deduction was disallowed by the Commissioner as not coming within the terms of Section 162 (a) and a deficiency was assessed accordingly. The Board of Tax Appeals sustained the Commissioner's determination. The Board found as a fact that during the year 1935 it was probable that these capital gains would be invaded for non-charitable purposes. (R. 37–38.)

II

During the year 1936, the taxpayer realized gross taxable income of $74,989.57. (R. 32.) At the time of Pauline Tonningsen's death on January 25, 1936, there was a balance in the income account of the trust of $4,922.22 which amount was transferred to the principal account on that date. (R. 9.)

A deficiency in estate tax had been proposed against the executors of the estate of John Tonningsen by virtue of the assets in the trust. (R. 10, 33.) The execu-

tors made claim upon the taxpayer for the payment of this deficiency. The taxpayer denied liability on the ground that the payments specified in Article VII (a) of the trust were to be made upon the death of the survivor of the trustors and no payments could be made for those purposes while Pauline Tonningsen was still alive. (R. 33.) A similar issue arose with respect to the California estate tax. (R. 33.) The taxpayer realized it might be liable so it employed counsel and sought to be recognized by the Commissioner as a taxpayer in those proceedings. (R. 33.) Over the objection of the taxpayer the Commissioner was permitted to introduce in evidence a letter from the taxpayer's attorney in which he stated, in appealing to the Commissioner to permit the taxpayer to be represented at the proceedings, that the taxpayer was willing to pay a share of the tax. (R. 11.) The efforts of the taxpayer resulted in a reduction of the proposed deficiency in the estate tax upon the estate of John Tonningsen. (R. 11.) On June 12, 1936, which was after Pauline Tonningsen's death, the executor of the estate of John Tonningsen and the taxpayer reached an agreement relative to the amount of federal and California estate taxes which the taxpayer would pay. (R. 33–34.) Under this agreement the taxpayer paid the executors of the estate of John Tonningsen $18,533.86. (R. 34.) The taxpayer charged this amount to principal on its records. (R. 34.) In July and December of 1936, the taxpayer paid to charities designated in the trust instrument a total of $17,178.44,

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charging these amounts against income on its records. (R. 34.)

The taxpayer took a deduction for the amount paid to charities in 1936 on the ground that these amounts were income paid to charities within the meaning of Section 162 (a). The Commissioner disallowed the claimed deduction on the ground that the amounts paid to charities were in reality paid not from income but from corpus and were therefore not deductible. The Commissioner's determination was sustained by the Board.

On November 16, 1935, the taxpayer had paid the attorney representing it in connection with the federal estate tax proposed deficiency, $500, and had charged the same to the principal account of the trust. On July 9, 1936, $500 was credited to the principal account and charged against the income account of the trust, and an additional $1,000 was paid to the attorney. Subsequently, on July 22, 1936, an additional $6,000 was paid to the attorney and charged to the income account. (R. 12–13.)

The taxpayer took a deduction for the attorney's fee in its return for 1936 as a business expense. The Commissioner disallowed the claimed deduction, and was sustained by the Board.

SUMMARY OF ARGUMENT

I

A deduction is not permissible under Section 162 (a) if under the terms of the will or deed of trust there is

any possibility that the income may be used for purposes other than charitable. Not only is this the plain meaning of the words of Section 162 (a), which allows a deduction only of amounts *permanently set aside* for charity, but policy considerations require that the statute be so construed. If the deduction be allowed even though there is a possibility that the income will be diverted to non-charitable purposes, there would be no opportunity to tax the income later if it were diverted, and the congressional intent to tax all income would be frustrated. Furthermore, deductions depend upon legislative grace, provisions granting them must be strictly construed, and a taxpayer must come squarely within the terms of a section permitting a deduction to be entitled thereto. Application of this test to the facts herein requires the denial of the deduction, since the capital gains here involved were subject to many possibilities of diversion from charitable uses.

Although some cases have held that if there is a practical certainty that the income will be used for charitable purposes Section 162 (a) is satisfied, this rule defeats rather than aids the congressional purpose to encourage charitable contributions, for the rule stimulates the hedging of charitable gifts with conditions. But even if this test be applied to the instant case the taxpayer cannot succeed. The question of the probabilities of diversion of the income to non-charitable purposes is one of fact. The Commissioner's determination is presumptively correct; and the Board of Tax Appeals having resolved the fact issue against the tax-

payer, its finding must be sustained if there is substantial evidence in the record in support thereof. The evidence fully supports the Board's conclusion. Comparison of the facts herein with the facts in the cases relied upon by the taxpayer reveals such a great difference in degree that the taxpayer can derive no support from those cases.

The arguments based on Sections 167 and 162 (c) are not open to the taxpayer since they are not within the statement of points intended to be relied upon on appeal. Moreover there is no merit to the arguments based on those sections. Section 167 is not applicable because there is no proof that Pauline Tonningsen was the grantor of this trust. On the contrary the evidence indicates that John Tonningsen was the grantor. Section 162 (c) does not apply where, as here, the capital gains become part of the corpus under state law.

II

The claimed deduction for 1936 is not allowable if the terms of the trust indenture directed the payment of taxes from income. The terms of the trust are explicit on this point, leaving small room for construction. They expressly direct the payment of taxes from income, if sufficient. Since the income was sufficient to meet this payment, the claimed deduction is not allowable.

The payment of a fee to an attorney is not a payment to charity and is therefore not deductible under Section 162 (a).

ARGUMENT

I

(a) The claimed deduction does not come within the scope of Section 162 (a)

Section 162 (a) of the Revenue Act of 1934 authorizes the deduction from gross income by trust estates of the amount—

> which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;
>
> *   *   *   *   *

We agree with the taxpayer that the statute makes the deduction depend upon the terms of the deed creating the trust. In order for the taxpayer to be entitled to the benefit of this section it must demonstrate that the capital gains in question were "paid or permanently set aside" for charitable purposes *pursuant to* the terms of the trust indenture.

The courts have adopted two tests in resolving the question whether income accruing to a trust estate is deductible under the terms of this section. We submit that the proper test is that enunciated in *Boston Safe Deposit & T. Co.* v. *Commissioner,* 66 F. (2d) 179 (C. C. A. 1st), certiorari denied, 290 U. S. 700, and *Charles P. Moorman Home for Women* v. *United States,* 42 F. (2d) 257 (W. D. Ky.). See also *Pennsyl-*

vania Co. for Insurances, Etc. v. *Brown,* 6 F. Supp. 582 (E. D. Pa.), affirmed *per curiam,* 70 F. (2d) 269 (C. C. A. 3d). The test laid down by these cases is as follows: If under the terms of the will or deed of trust there is any possibility that the income may be used for purposes other than charitable, then the deduction is not allowable. This is the only construction which gives full meaning and content to the words of Section 162 (a). It will be noted that the statute requires that the income be either paid or permanently set aside for charitable purposes. The words "permanently set aside" must be construed in the light of the use of the word "paid", and it would therefore seem that Congress intended that before the deduction could be taken there be an absolute certainty that the money would be used for charitable purposes. Further strength is given to this construction by the use of the word "exclusively" in the remaining portion of this section. Unless the test be the one adopted in the foregoing cases the words "permanently set aside" and "exclusively" are delimited to the point where they are deprived of their proper meaning.

Policy considerations also dictate that this is the only reasonable construction to give to the statute. The income from the trust estate must be taxed in the year in which it is realized or never. Once the deduction is allowed, there is no opportunity to tax the income if it is diverted; it was for this reason that Congress required definite assurance that income be irrevocably dedicated to charitable purposes before it be relieved from the burden of tax. Congress wished to encourage chari-

table contributions and provided for a deduction from gross income in aid of that purpose. But this purpose is subsidiary to the general all-pervading purpose of the revenue act to tax all income. *Helvering* v. *Butterworth,* 290 U. S. 365. In allowing the deduction for income to be used for charitable purposes Congress chose the words used in order to render certain that no deduction would be taken unless it was absolutely certain that the money would go for those purposes. When there is added to these considerations the rule that deductions depend upon legislative grace, provisions granting them must be strictly construed, and a taxpayer must come squarely within the terms of a section permitting a deduction to be entitled thereto [*New Colonial Co.* v. *Helvering,* 292 U. S. 435; *Helvering* v. *Northwest Steel Mills,* 311 U. S. 46; *Sparkman* v. *Commissioner,* 112 F. (2d) 774 (C. C. A. 9th)], we submit that the deduction permitted by Section 162 (a) is not available if there is any possibility of diversion to non-charitable purposes.

There are, however, decisions to the effect that if the possibility of the use of the fund for non-charitable purposes is so remote that it may be said that there is a practical certainty that the funds will be devoted to the charitable purpose, the deduction is permissible. *Commissioner* v. *F. G. Bonfils Trust,* 115 F. (2d) 788 (C. C. A. 10th);[2] *Hartford-Connecticut Trust Co.* v. *Eaton,* 36 F. (2d) 710 (C. C. A. 2d); see also *City Bank Farmers' Trust Co.* v. *United States,* 74 F. (2d) 692 (C. C. A. 2d). This test is applied upon the theory that

[2] Note the strong dissent by Judge Bratton.

since the purpose of Congress was to encourage charitable contributions the section should be construed liberally. We submit, however, that this construction defeats rather than aids the congressional purpose. A decision which allows the deduction from gross income of gains accruing to a trust despite the fact that those gains are subject to invasion for non-charitable purposes, will encourage testators and grantors to hedge charitable gifts with conditions. Far greater aid would be rendered to the congressional purpose by a decision that a deduction is not allowable unless there are no conditions attached to the dedication of the money to charitable purposes. Once strings are allowed to be attached to a charitable gift without defeating the right to a deduction under Section 162 (a), impetus is given to the creation of trusts having such strings attached. Certainly in many cases the occasion will arise when the conditions will come into full force and effect and thereby defeat the ultimate gift to charity.

The decisions applying the probability test rely upon *Ithaca Trust Co.* v. *United States,* 279 U. S. 151. That case involved Section 403 (a) (3) of the Revenue Act of 1918, which permitted the deduction from the gross estate subject to estate tax of the amount of gifts to charities. In that case the testator gave the residue of his estate to charities subject to a life estate in his wife with authority to invade the corpus to the extent "that may be necessary to suitably maintain her in as much comfort as she now enjoys." The Supreme Court held that the language of the will had placed a limit upon the possible invasion of the corpus

which was capable of definite measurement in terms of money and therefore the residuary gifts to charity could be computed and deducted from the value of the gross estate. It is to be noted that that case arose under a statute which allowed a deduction of the *amount* of a gift to charity. The only problem presented was whether the value of the residuary bequest could be determined at all. Cf. *Humes* v. *United States,* 276 U. S. 487. But the question here is not simply one of attempting to place a value on the charitable gift, but whether the income was *permanently set aside* for charitable purposes. The *Ithaca Trust Co.* case does not authorize courts to speculate. Moreover, the narrowly and definitely limited possibility of corpus diversion for non-charitable purposes in the *Ithaca Trust Co.* case is not here present.

The limits of the application of the *Ithaca Trust Co.* case are demonstrated by the recent decision in *Gammons* v. *Hassett,* 121 F. (2d) 229 (C. C. A. 1st). That case involved the same issue which was presented in the *Ithaca Trust Co.* case, namely, the deductibility of a residuary bequest to charity from the gross estate under the estate tax. There the decedent bequeathed the residue of his estate to named charities subject to a direction (p. 230) that the income and "so much of the principal thereof as my said wife may at any time and from time to time need or desire, * * * be paid to my said wife during her life." At the time of the death of the decedent his wife was 93 years old and had been bedridden for more than

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> of the home, and that meantime the value of the assets had increased, it cannot be foretold whether that situation will always obtain. There is always the possibility that, because of economic changes or unsuccessful management, the income will diminish, with the result that the annuities will have to be paid in whole or in part from the corpus, as they were during the period immediately following the testator's death, and the residuary estate for charitable uses thus reduced. Clearly, until by complete discharge of all the annuities upon death of the several beneficiaries the estate is freed from the charge laid upon it for their payment, no amount certain, either of corpus or income, can be said to be definitely and permanently set aside exclusively for charitable uses. * * *

If this test be applied to this case it is obvious that the taxpayer is not entitled to the claimed deduction. Any one of the various conditions attached to the gift to charity in this case would be sufficient to defeat the right to a deduction.

However, even if the question be viewed as one of probabilities the taxpayer cannot succeed. The case upon which the taxpayer relies most heavily, *Commissioner* v. *F. G. Bonfils Trust, supra,* holds that this question is one of fact. The Commissioner's determination was adverse to the taxpayer and his determination is presumptively correct. *Welch* v. *Helvering,* 290 U. S. 111, 115. In addition the Board has found as a fact that the actual probabilities were that the capital gains here in question would be invaded for non-charitable purposes and its decision must be sustained by this Court

if there is substantial evidence to support it. *Helvering* v. *Kehoe,* 309 U. S. 277; *Lauriston Inv. Co.* v. *Commissioner,* 89 F. (2d) 327 (C. C. A. 9th).

The use of the probability test in the construction of the statute makes the question primarily one of degree. A comparison of the facts in this case with the facts in the cases which have applied the probability test reveals such a great difference in degree that no support is lent to the taxpayer's position by those cases.

In the *F. G. Bonfils Trust* case, *supra,* the issue, as in this case, was whether capital gains were permanently set aside for charitable purposes within the meaning of Section 162 (a). There the corpus of the estate was approximately $8,000,000, of which almost one-half was invested in Government and municipal bonds. The current income was approximately one-half million dollars and the average annual income for five years had been about that figure. The only possibility of corpus invasion was to make good annuities approximating $100,000 a year. Of the ten annuitants, two had already died, one was past 80, three were past 70 and two were past 60. The majority of the court said that it was certain that there would be a decrease in the amount of annuity payments in the near future, and reached the conclusion that the evidence established beyond a reasonable doubt that there would never be any recourse to the corpus to pay the annuities.

In *Hartford-Connecticut Trust Co.* v. *Eaton,* 36 F. (2d) 710 (C. C. A. 2d), the income from an estate

of $1,000,000 was to go to the decedent's wife and the trustee had the power to invade the principal to support her according to her station in life. The case came up on a demurrer to a complaint which alleged that the widow lived in a "modest way"; that she had an income of her own; and that "her character, taste," and "standard of living" were such "that there was at no time any reasonable possibility that the plaintiff as trustee would deem it necessary or advisable to use any part of the trust fund for her comfortable maintenance and support." Essentially the same situation was presented in *Hartford-Connecticut Trust Co.* v. *Eaton,* 41 F. (2d) 69 (Conn.), which also arose on a demurrer. In that case the only possibility of corpus invasion was to meet a $5,000 annuity, but the corpus was over a million dollars and had produced income for a six-year period of from $70,000 to $120,000 annually. In *Hartford Nat. B. & T. Co.* v. *Hartford-Connecticut T. Co.* (Conn.), decided September 17, 1937, not officially reported but may be found in 20 A. F. T. R. 1325, the annuity which was made a charge on the corpus was only $6,000, whereas the estate had a value of $1,700,000, had grown to this size in fifty years from $342,000, and was producing income in excess of $80,000 per year. The court found as a fact that there was no chance of corpus invasion.

The facts in the case *sub judice* are not at all comparable to the facts in any of these cases. In the first place, the net income of the trust here suffered a serious decline from 1931 to 1935. There is no record

here of extremely successful management of the trust estate as there was in *Hartford Nat. B. & T. Co.* v. *Hartford-Connecticut T. Co., supra.* Secondly, it is to be noted that in the *F. G. Bonfils Trust* case the court deemed it of great importance that approximately half of the $8,000,000 corpus was invested in governmental obligations. According to Exhibit H (R. 53), the 1936 income of this estate (aside from capital gains) was derived exclusively from rentals, except for a small amount derived from dividends. In comparison with governmental obligations rentals are extremely hazardous from the standpoint of yield. Thirdly, in each of the other cases there was only one condition attached to the ultimate disposition of the corpus to the charities. In this case the interest of the charitable organizations was subject to many prior charges: (a) the possibility of invasion of corpus in order to provide for the care, maintenance, support, illness or other emergencies of Mrs. Tonningsen; (b) the payment of the various costs, expenses and taxes enumerated in Article VII (a) of the trust, which were made a charge upon the principal; (c) the payment of the sum of $104,000 to specific individuals which was also a charge upon the corpus; and (d) the payment of annuities amounting to $7,200 per year.

The effect of these prior charges must be measured with respect to the situation as it existed in 1935. The statute requires that the amounts sought to be deducted be permanently set aside for the designated purposes *during the taxable year.* Anything occurring after the taxable year could not affect the ques-

tion whether the amounts were so set aside during the prior year. Therefore the death of Mrs. Tonningsen early in 1936 is without significance upon this question. See *Ithaca Trust Co.* v. *United States,* 279 U. S. 151.

The taxpayer has stated that by no stretch of the imagination could Mrs. Tonningsen's needs exceed the approximate $4,000 which the income of the trust furnished her, relying upon the evidence of her hotel bills and medical expenses. But there is no evidence in the record to show that these were the *only* expenses which she had. There are no facts to show for what other purposes Pauline Tonningsen spent money, or that she was a frugal woman. The taxpayer's assertion that she apparently accumulated over $20,000 *from payments made to her by the trustee,* is pure conjecture. There is no evidence showing *all* of Mrs. Tonningsen's receipts and disbursements. The very fact that she demanded more than the net income from the trust is evidence to show that her needs were in excess of that income. Moreover by the terms of the trust the corpus was subject to invasion to provide for illness or other emergencies befalling Mrs. Tonningsen. Who could have said in 1935 that her illness would not later require large sums or that some other emergency might not arise?

No significance attaches to the fact that Mrs. Tonningsen had a separate estate, for the general rule is as follows (4 Bogart, Trusts and Trustees, Sec. 812, p. 2352):

> If the trust is for the purpose of supporting the life beneficiary, and the trustee is given dis-

> cretion as to the amount necessary, he may pay from the trust funds whatever is needed for such support, even though the cestui has other income. The intent of the settlor is not that the trust shall supplement existing income of the cestui, but he has expressed a wish to furnish all the income needed for support. * * *

and in Restatement, Trusts, Sec. 128, Comment e, p. 327:

> It is a question of interpretation whether the beneficiary is entitled to support out of the trust fund even though he has other resources. The inference is that he is so entitled. * * *

See also 1 Scott on Trusts, Sec. 128.4.

Estate of Smith, 23 Cal. App. (2d) 383, 73 P. (2d) 239, is not to the contrary. It merely holds that a court will not interfere with the exercise of discretion by a trustee unless it is abused. With respect to the question presented here, *power* in the trustee to invade the corpus for the benefit of Mrs. Tonningsen without regard to her other resources is the controlling consideration.

With regard to the annuities it is to be noted that there is no evidence in the record concerning the ages of the annuitants or their life expectancies. During the taxable year in question the corpus was invaded for non-charitable purposes to the extent of $9,545.80, and in the preceding year to the extent of $16,614.53. As the Board said, the actual facts demonstrated that substantial amounts were taken from the corpus in each year. Of course as the corpus was depleted the income would drop, thus necessitating increasingly

drastic invasions of the corpus. Furthermore at the death of Pauline Tonningsen the trustee was required to distribute a large portion of the estate to specific beneficiaries and to pay various costs, expenses and taxes. The application of a substantial part of the corpus to these purposes would leave a seriously depleted estate to bear the charges of the annuities.

We submit that upon these facts the petitioner is placing the responsibility of omniscience upon this Court in attempting to obtain a ruling that the income from this trust will be sufficient for an indeterminate number of years to meet the cost of these annuities even after the estate has been seriously depleted by the various other prior charges. We think it is apparent from the comparison of the facts in this case with the facts in the cases relied upon most heavily by the taxpayer that there is no parallel between his authorities and his case. Little need be said about the other cases cited by the taxpayer on this point. In *First Nat. Bank* v. *Snead,* 24 F. (2d) 186 (C. C. A. 5th), which involved the deduction allowable under the federal estate tax, the case also arose on a demurrer and the facts were comparable to the *Ithaca Trust Co.* case. *Lucas* v. *Mercantile Trust Co.,* 43 F. (2d) 39 (C. C. A. 8th), and *Millard* v. *Humphrey,* 8 F. Supp. 784 (W. D. N. Y.), also involved the issue in, and presented facts parallel to, the *Ithaca Trust Co.* case. *Bowers* v. *Slocum,* 20 F. (2d) 350 (C. C. A. 2d), affirming 15 F. (2d) 400, (S. D. N. Y.), merely decided that when income is irrevocably dedicated to charitable corporations by the terms of a will it is unnecessary that

it be paid or credited to the beneficiaries by the trustee in the taxable year in order to be deductible.

The taxpayer argues that the payments were not made pursuant to the terms of the trust but were made out of the funds of the charitable remaindermen. The fact that the trustee refused to make any payments from corpus without the consent of the remaindermen, is, of course, no evidence that Pauline Tonningsen had no right to payments from corpus. The trustee merely acted with prudence in order to protect itself. The contention that the payments were not made pursuant to the terms of the trust but were made from the funds of the charitable remaindermen requires the surprising conclusion that the charities either misappropriated their funds or else had power to use their funds to benefit private wealthy individuals. If the charities did have such power then the deduction would not be allowable under the express terms of Section 23 (o).

The argument that the average payments from the corpus to the life beneficiary would have had to continue for forty years in order to exhaust the residue of the corpus obviously misses the point. In the first place, each invasion of the corpus would result in a corresponding reduction of the income thereby requiring greater invasions in the following year. The invasions would progress geometrically, not arithmetically. Secondly, the taxpayer attempts to show that each one of the conditions attached to the dedication of this trust fund to charities would not of itself defeat the ultimate enjoyment of the fund by the chari-

ties but, of course, the case can not be so broken down. It is necessary to determine whether the combined effect of all the conditions makes it impossible to say that there was a practical certainty that the capital gains here in issue would ultimately go to the charities.

(b) Neither Section 167 nor Section 162 (c) authorizes the claimed deduction

The taxpayer has raised for the first time in its brief the contentions that if the capital gains were not deductible under Section 162 (a) of the Revenue Act of 1934, they were deductible under Sections 167 and 162 (c). We submit that these contentions are not available to the taxpayer at this stage of the case. The statement of points to be relied upon on appeal is long and detailed and, aside from the general allegation that the Board of Tax Appeals erred in deciding that there was a deficiency, none of the points raises the questions here sought to be litigated. Rule 19 (6) of this Court states in mandatory language that this Court will consider only those points which have been stated as points on which the appellant intends to rely. This objection has more than technical merit. Since the statute of limitations now bars any additional assessment against Pauline Tonningsen (Sec. 275, Revenue Act of 1934), it would be most unfair to permit the taxpayer at this time to contend that this income was not its income at all—a position diametrically opposed to its prior position.

If the Court should come to consider the taxpayer's contentions with respect to Sections 167 and 162 (c)

on the merits, then we submit that there is no validity to the taxpayer's arguments. With respect to Section 167, it is only necessary to point out that that section applies only where income may be accumulated for the benefit of the *grantor.* It was and is therefore requisite for the taxpayer to demonstrate that Pauline Tonningsen was the grantor of this trust. As was said in *Buhl* v. *Kavanagh,* 118 F. (2d) 315, 320 (C. C. A. 6th):

> The word "grantor" is not defined in the statutes, and therefore is to be given its natural, ordinary and familiar meaning. *DeGanay* v. *Lederer,* 250 U. S. 376, 381, 39 S. Ct. 524, 63 L. Ed. 1042. Putting the word in its ordinary setting, it means the person who establishes the trust or its donor, creator or founder. An express trust must be an explicit declaration of trust, accompanied by an intention to create such an estate and followed by an actual conveyance or transfer of definite property, or estate or interest made by a person capable of such a transfer and for a definite term, which vests the legal title in a person capable of holding as trustee for the benefit of a *cestui que* trust or purpose, to which the trust fund is to be applied or the retention of title by the owner under circumstances which clearly and unequivocally disclose intent to hold for use of another. Obviously a person who has no title or interest in property can create no trust therein. *Brainard* v. *Commissioner,* 7 Cir., 91 F. 2d 880. * * *

There is no evidence in the record to sustain such a conclusion. Whatever evidence there is on this point tends to the conclusion that John Tonningsen was the grantor. The fact that the trust speaks of John Tonningsen as

first trustor and Pauline Tonningsen as second trustor is immaterial. Those words may have been used simply as a means of designating particular persons by the draftsman of the instrument. In *Buhl* v. *Kavanagh, supra,* the court did not consider it important that a particular person was named as grantor.[3] The fact that the value of the trust was taxed to the estate of John Tonningsen under the estate tax indicates that he was the grantor. Moreover the taxpayer's consistent contention that the income here involved was income of the trustee and deductible under Section 162 (a) involves a representation that Pauline Tonningsen was not the grantor of the trust. The only other reference to this question which may be gleaned from the record is the letter of John L. McNab, an attorney, to the San Francisco Unit of the American Red Cross (Ex. E, R. 45). The first two paragraphs of this letter read as follows:

> I recall to your attention the fact that John Tonningsen before his death established a trust of about half a million dollars with the Bank of America for six beneficiaries, of which you are one.
>
> In reality this was not John Tonningsen's property. It was the property of his wife. She was inclined to attack the trust and had she done so would probably have been successful. She was persuaded not to engage in litigation.

Of course, this letter is hearsay and does not establish the fact that Pauline Tonningsen was, in fact, the

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[3] *Buhl* v. *Kavanagh*, 118 F. (2d) 315, 321:

> It is true that in the form in which the present transaction was consummated, appellant was referred to as the grantor of the trust. This does not preclude the inference that her father was in fact the grantor. * * *

grantor of this trust. If the letter be considered at all it merely indicates that there is a great deal of doubt about who was, in fact, the grantor of the trust. Since the taxpayer is relying on Section 167, the doubt must be resolved against it.

The argument based on Section 162 (c) must also fail. The rule is well settled that capital gains which become part of the corpus under state law are not deductible by the trustee under this section even though the trustee in the exercise of the power to distribute corpus actually distributes the capital gains. *Helvering* v. *Pardee,* 290 U. S. 370; *Weigel* v. *Commissioner,* 96 F. (2d) 387 (C. C. A. 7th); *Chambers v. Commissioner,* 33 B. T. A. 1125; *Old Colony Trust Co.* v. *Commissioner,* 38 B. T. A. 828. The reason for the rule is fundamental. Although such capital gains are taxable income within the meaning of the Revenue Act, distributions of corpus are not taxable to the distributee according to Section 22 (b) (3). If the trustee were allowed a deduction under the terms of Section 162 (c) in these circumstances, then the income would escape taxation altogether.

II

(a) The payments made to charities in 1936 were not made from income, and if they were made from income they were not so made pursuant to the terms of the trust

The deduction allowed by Section 162 (a) is not allowable unless the amounts paid to charities are so paid pursuant to the terms of the trust. We contend that the amounts paid by the taxpayer to the charities, which the taxpayer designated in its accounts as

paid from income, were not payable from income according to the terms of the trust. As the Board stated (R. 39):

> The issue, therefore, narrows to the question whether the trust instrument provided that the payments of estate taxes and attorneys' fees should be made from income or whether it directed that the income should be used for the payments to charity.

Of course, the action of the trustees in crediting the various payments in 1936 to the principal and income accounts is not determinative.

The terms of Article VII (a) of the indenture are so clear that there is, as the Board said, "small room for construction". The instrument provides that the taxes, costs and expenses be paid "out of the income of the trust fund and estate, if that be sufficient, or out of the principal thereof, if necessary, * * *." (R. 40.) Since at the time these payments were made income was available to meet them, the trustee was required to meet the charges from income. The suggestion that the sufficiency of the income to meet the charges of Article VII (a) should be determined as of the date of the death of Pauline Tonningsen is without merit, for this would render the direction to pay these charges from income meaningless since all of the income up to the date of Pauline Tonningsen's death was payable to her. The taxpayer makes point of the fact that the payment in question "was not made by virtue of any governmental demand for inheritance or estate taxes, nor was it made to any person or instru-

mentality claiming a preferred claim or charge on the trust estate." (Br. 54–55.) Aside from the questionable accuracy of this statement in view of the fact that the trustee sought to be recognized as a taxpayer in the John Tonningsen estate tax proceedings, the point is obviously immaterial. Article VII (a) of the indenture requires the payment of estate taxes *due* upon the trust fund and estate. It is not limited to the payment of estate taxes upon which the trustee *was liable.*

The argument that the taxes mentioned in Article VII (a) are those arising on the death of the survivor of John and Pauline Tonningsen has no basis in the terms of the trust instrument. The taxes which the trustee was directed to pay were the "inheritance tax upon all distributive shares of or interests in the trust fund and estate, if any be due, and *any* Federal Estate tax due upon the whole thereof." (Italics ours; R. 29.) Of course, the governmental agencies would not be required to defer collection of taxes with respect to this trust estate until the death of the survivor of John and Pauline Tonningsen, but there is no reason why the executors of the estate of the decedent whose estate was charged with these taxes could not be required to wait until the death of the survivor in order to secure reimbursement from the trustees. The trust instrument so provided and the trustees took that very position when the executors of the estate of John Tonningsen demanded payment before Pauline Tonningsen had died.

(b) The payment of a fee to an attorney is not a payment to charity within the meaning of section 162 (a) of the Revenue Act of 1936

Little need be said with respect to the claimed deduction of the attorney's fee. The deduction was first claimed as a business expense but that contention has been abandoned. The deduction is now claimed on the basis of Section 162 (a). We point out that this contention is not covered by the statement of points intended to be relied upon on appeal. But quite aside from this point, Section 162 (a) allows the deduction only of amounts paid to charities. Certainly the attorney who received this fee did not receive it as charity. The statute does *not* provide that the expenses of a trust estate which pays part of its income to charity may be deducted.

CONCLUSION

The decision of the Board of Tax Appeals is correct and should be affirmed.

Respectfully submitted.

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September, 1941.

APPENDIX

STATUTES INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

* * * * *

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduc-

tion shall be included in computing the net income of the legatee, heir, or beneficiary.
(U. S. C., Title 26, Sec. 162.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question".
(U. S. C., Title 26, Sec. 167.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this title shall be assessed within three years after the return was filed,

and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(c) *Amission from Gross Income.*—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

* * * * *

(U. S. C., Title 26, Sec. 275.)

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

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